

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION

WASHINGTON, D. C.

ORDER NO. 981

IN THE MATTER OF:

Application of D. C. Transit  
System, Inc. for Authority to  
Increase Fares.

Application of D. C. Transit  
System, Inc. for Authority to  
Increase Fares.

Served October 17, 1969

Application No. 226

Docket No. 32

Application No. 344

Docket No. 101

APPEARANCES:

STANLEY O. SHER and LEONARD BEBCHICK, appearing for  
Protestants.

HARVEY M. SPEAR, attorney for D. C. Transit System,  
Inc., Applicant.

DOUGLAS N. SCHNEIDER, JR., General Counsel, Washington  
Metropolitan Area Transit Commission.

BEFORE GEORGE A. AVERY, CHAIRMAN; WILLIAM O. DOUB, VICE  
CHAIRMAN, AND H. LESTER HOOKER, COMMISSIONER.

I

PROCEDURAL HISTORY

This Order, and the proceedings leading up to it, have their origin in the opinion of the U. S. Court of Appeals in Williams v. WMATC, (D.C. Cir. Nos. 20,200, 20,201, and 20,202 respectively), issued on October 8, 1968. In that opinion, the Court of Appeals set aside Commission Orders Nos. 245 and 563, and portions of Order No. 564, relating to fares for D. C. Transit System, Inc. (Transit).

The orders first referred to, i.e., Nos. 245 and 563, established Transit's authorized rate structure for the period from April 14, 1963 through January 26, 1966. The other order, No. 564, established Transit's authorized rate structure for the period from January 27, 1966 through March 14, 1967.

The court's disposition of these orders led it to remand the proceedings to us for consideration of certain issues involving the following subject matters: (1) The amortization of the acquisition adjustment account; (2) The deficiency in Transit's depreciation reserve; (3) The treatment of the investment tax credit; (4) The restitution of any excess return in the periods covered both by Orders Nos. 245 and 563 and Order No. 564. The court's views on these subjects, and their instructions to us, are discussed in detail as we take up each subject. Hence, no further discussion of them is needed at this juncture.

Transit sought review by writ of certiorari in the Supreme Court of the court of appeals ruling, thus staying issuance of the mandate to this Commission. The Supreme Court denied certiorari on February 24, 1969, and the court's mandate was issued on March 3, 1969. Shortly thereafter, we instructed the parties to prepare for pre-hearing conferences on the subject of further proceedings before the Commission in accordance with the court's opinion.

These pre-hearing conferences, presided over by the Commission Chairman, were held on May 7, 1969 and June 11, 1969. The parties

and staff submitted written statements of suggested issues and on June 17, 1969, the Commission issued Order No. 955 which set out an extensive agreed statement of issues on remand. Meanwhile, in accordance with the court's request that the parties seek agreement as to the amount of restitution and the details for its accomplishment, Transit and protestants met, with the Commission staff in attendance, to explore the possibility of agreement. These efforts were unsuccessful and it was necessary to go to hearing on all issues. Hence, formal hearings were held on July 17, 18, and 25, 1969, producing a 604-page record.

Protestants presented the testimony of Mr. Melwood W. VanScoyoc, a public utility consultant, who testified on all aspects of the matters in issue; and Mr. Zane Cole of the D. C. Department of Finance and Revenues who testified as to the method of valuation of property by the tax assessors office. Protestants also called Mr. Samuel Hatfield, Vice President and Comptroller of D. C. Transit, on the question of the value of certain of Transit's properties. Transit presented testimony of Mr. Hatfield and Mr. John Curtin, a transportation engineer and independent consultant. The staff submitted testimony of Edwin Brubaker, assistant chief auditor of the Commission. A total of 31 exhibits were received in evidence. Briefs and reply briefs were submitted by protestants and by the company.

## II

### STRUCTURE OF THIS OPINION

We have reviewed and considered the evidence presented by all parties, along with their post-hearing briefs and reply briefs and we will, in this opinion, fully discuss and rule upon the issues presented to us. We are frank to say that the theories and arguments evolved by the parties in the remand proceedings have presented us with some of the most difficult and complex issues we have encountered in our regulatory experience. We have made every effort here to consider and sort out the conflicting contentions, to present them in clear and logical form, to reach that disposition which is consistent with the court's intent, and to set out, fully and clearly, the reasoning underlying our actions.

The opinion is a somewhat lengthy one and it might be helpful at this point to describe its structure. We will take up first each of the subjects involving the court-ordered reserve, generally in

the order in which the court dealt with them.<sup>1/</sup> Thus, there follow sections on (1) The Acquisition Adjustment Account; (2) Depreciation Reserve Deficiency; and (3) Excess Return.

Following these major subjects from the court opinion, we discuss the treatment of the court-ordered reserve, including a discussion of

- (1) The question whether credits to the reserve should be book entries or cash credits;
- (2) The subject of interest on amounts placed in the court-ordered reserve;
- (3) The impact on the court-ordered reserve of our denial of a return on equity in Orders Nos. 880 and 900.

Next, we take up our treatment of the investment tax credit. There follows a discussion of protestants' request that we retain jurisdiction for determination of a fee.

We then set out a summary and conclusion, followed by the necessary ordering paragraphs.

There are nine appendixes setting forth detailed financial findings.

Finally, the opinion is, naturally, replete with references to the court's opinion in Williams v. WMATC, D.C. Cir. Nos. 20,200, 20,201, 20,202, decided Oct. 8, 1968. That opinion has not yet been reported. For convenience in reading, references to the opinion will state merely "Williams, p. \_\_", the page references being to the slip opinion.

### III

#### AMORTIZATION OF THE ACQUISITION ADJUSTMENT ACCOUNT

We take up first the subject of the Acquisition Adjustment Account. We had occasion at the outset of this opinion to remark upon the complexity of the issues raised before us on remand. This complexity reached Byzantine proportions by the time the parties finished their presentations on this item. We will endeavor in this discussion to set out and dispose of the issues in a manner

---

<sup>1/</sup> The discussion of excess return covers both Orders Nos. 245 and 564 in one section. The discussion of investment tax credit follows the other sections because, as all parties agreed, it involves no impact on the court-ordered reserve.

understandable to one not fully versed in all the convolutions involved.

We should begin with the origins of the Acquisition Adjustment Account. The court's opinion summarizes that subject as follows:

"The event giving rise to this account was Transit's purchase in 1956 of properties from its predecessor, Capital Transit Company (Capital), at a price lower by \$10,339,041 than the net original cost of those properties to Capital. Transit's allowances for depreciation thereon could, of course, have been related to its own acquisition cost; but this would have required the development of new depreciation rates computed on remaining life, and new depreciation bases derived in part from distribution of the purchase price among the items of property acquired. To save the labor incidental to that process, however, the Public Utilities Commission of the District of Columbia (PUC), the Commission's predecessor, ordered that two things be done. One was the establishment of the acquisition adjustment account to accommodate an amortization, over a ten-year period beginning August 15, 1956, of the \$10,339,041 difference in acquisition cost to Capital and Transit respectively. The other was a direction that depreciation be accrued on the basis of Capital's original cost and at the rate previously fixed for Capital, with ten annual offsetting credits to operating expenses of \$1,033,904 derived from the amortization.

"PUC selected the ten-year period for amortization in order to link it to an annual accrual of \$1,044,196 over the identical period to a reserve designed to absorb Transit's estimated future expenses for track removal and street repaving incidental to its franchise-required conversion from Capital's trolley-bus operation to Transit's eventual all-bus operation. With the amortization and the accrual in almost the same annual amount for exactly the same period, any material impact from either upon Transit's income posture would be avoided." Williams, pp. 41-43. [Footnotes omitted.]

The present problem stems from the fact that, beginning January 1, 1963, the Commission suspended further accruals to the track removal reserve. At the same time, it undertook to re-examine the manner in which the balance then remaining in the Acquisition Adjustment Account would be amortized. As of January 1, 1964, the Commission did change the method of amortization. See WMATC Order No. 385. Instead of writing off the remaining balance by August 15, 1966, the Commission directed that the remaining balance be written off, in equal amounts each year, beginning January 1, 1964, and ending August 14, 1976, the date on which Transit's franchise expires.

The court rejected this treatment of the account. The court did not take exception to changing the amortization period and amortization amount. Rather, it felt that the Commission had erred in choosing the basis for the new annual amortization amount. The court pointed out the conceptual relationship between the reserve and the depreciation accruals on the properties acquired by Transit in 1956. By using an equal amortization figure each year, as the Commission did in Order No. 385, there would be a divergence between the rate at which the acquisition adjustment balance was being amortized and the rate at which the properties acquired in 1956 would be retired. This was not proper, said the court, and it, therefore, held that in changing the amortization period, we "must maintain, subsequent to the changeover date, a reasonable relationship between the amortization and accruals of depreciation of the properties remaining in service." Williams, p. 51. In summarizing its directives, the court said:

"The issue concerning the acquisition adjustment account is remanded to the Commission for a redetermination of the schedule for amortization of the balance thereof on the changeover date, and a relating of that schedule to the remaining lives of the properties in service on the changeover date. Any amounts heretofore charged against the account in excess of the amounts found to be proper shall be deposited in the court-ordered reserve." Williams, p. 98.

This, then, is the task before us. We must determine a new and proper basis for amortization of the balance in the Acquisition Adjustment Account as of January 1, 1964. Any amounts charged against the account which are in excess of the amounts we here find to be proper are to be placed in the court-ordered reserve.

The first issue to be determined is the balance in the account as of January 1, 1964. All parties are agreed that the basic amount is \$2,519,459. However, Transit proposes that this amount be reduced by \$187,234 and in so doing raises an issue that we can dispose of at this juncture. Transit's reduction is related to the fact that certain of the properties acquired in 1956 were subsequently transferred to below-the-line status. Transit argues that the essential purpose of the acquisition adjustment account was to adjust the amount of depreciation expense which Transit would be entitled to charge the riding public so that that expense would reflect the actual cost to Transit, rather than the original cost to Transit's predecessor. Transit then points out that when property is transferred below the line, depreciation expense thereon is no longer charged to the riding public. Hence, they argue, an allocable share of the acquisition adjustment account should also be transferred below the line.

We do not accept this theory. First, we do not accept Transit's view of the essential nature of the acquisition adjustment account. While it did involve adjustment of depreciation expense, its essential purpose was to pass along to the riding public the bargain enjoyed by Transit as a result of the fact that the purchase price it paid was some \$10,000,000 under the book value of the property it acquired. That bargain price was not all attributable to depreciable property. To accept Transit's theory would mean that a portion of the benefit which that bargain involved would be lost to the riding public. Moreover, it would be lost as a result of a transaction which involves the other substantial benefits for the investors which result from transferring property below the line. We refuse to countenance such a result. We start, therefore, with the fact that the balance remaining to be amortized as of January 1, 1964, is the basic figure of \$2,519,459.

The next question to be resolved is the period of time over which this balance is to be written off. Three alternatives have been presented to us. The first, suggested by protestants would have us cut off amortization at December 31, 1970. The second would extend the period until August 15, 1976, the date on which Transit's franchise expires. The third would extend the amortization over the entire period, extending beyond 1976, in which the 1956 properties will be depreciating.

We reject the first alternative. We note, first, that when the Williams case was before the court of appeals, protestants vigorously argued that the Commission was in error in extending the amortization period until August 15, 1976. Yet in passing upon protestants' appeal, the court gave no indication that it regarded the use of this period as constituting error. It confined its holding to the relationship between the amortization amount and the depreciation accruals. We believe that the choice of a cut-off date should have some logic to it. It should not be simply an arbitrary date chosen to give a certain revenue effect. To us, there is logic in saying that the appropriate period in which to pass along Transit's bargain price to the rider is the period for which it was granted a franchise. Nor do we think that the basis on which protestants suggest the December 31, 1970, date possesses any merit. It is based on the suggestion that by that date, D. C. Transit will have been acquired by public authority. That possibility can only be considered conjecture at this point and we do not think it appropriate to determine the amortization period on the basis of such conjecture.<sup>2/</sup>

For similar reasons, we reject the third alternative, i.e., that of extending the amortization period beyond August 15, 1976, until all the 1956 properties are fully depreciated or retired. The vast bulk of the acquisition adjustment will be written off by the 1976 date in any event and there is no need to extend the period beyond that point. To put it simply, the logic of cutting off when the franchise ends outweighs the de minimis revenue effects which would result from going beyond that date.

Hence, we conclude that the appropriate period in which to write off the balance of \$2,519,459 remaining in the account on January 1, 1964, is the period between that date and August 15, 1976.

That brings us to the question as to the appropriate method of determining how much of the balance should be amortized in each year. Essentially, there were two different methods suggested at the hearing, each of which was based on the language used by the court. At one point, the court said that there must be a reasonable relationship between the amortization and "accruals of depreciation of the properties remaining in service." Williams, p. 51. At another point, the court said the amortization must be related to "the remaining

---

<sup>2/</sup> Protestants' own witness in the remand proceeding made as his primary choice the August 15, 1976, date. The 1970 alternative was preferred not by him but by counsel for protestants.



lives of the properties in service on the changeover date." Williams, p. 98. This latter reference ties in with the court's analysis of the amortization amounts compared to property retirements set out at pp. 46-48 of the Williams decision.

Recognizing these two themes, the parties presented us on remand with one amortization schedule which is related to the rate at which the 1956 properties have been and will be retired between January 1, 1964, and August 15, 1976. They also presented us with an amortization schedule related to the amount of depreciation expense accrued each year on the 1956 properties.<sup>3/</sup>

We think that either method would be consistent with the intent of the court. However, we will opt for the latter method -- i.e., the method related to depreciation accruals (which we will refer to as the depreciation dollar method). For one thing, the depreciation dollar method has the virtue of being agreed to by all parties -- the protestants, the company, and the staff. Hence, the area of controversy is reduced. For another thing, we think this method gives fuller recognition to the court's characterization of the conceptual relationship between the acquisition adjustment account and depreciation expense.

We will, therefore, compute the amount of acquisition adjustment which should have been amortized in accordance with the depreciation dollar method and compare that figure with the amount actually amortized. Before doing so, however, we must determine the date as of which this comparison should be made. From that date forward, the proper amortization shall be shown in the company's reported figures. Prior to that date, the adjustment should be made by appropriate restitution measures in this proceeding. After careful consideration, we have determined to use December 31, 1968. There is significant merit for purposes of ease of future understanding, ease of reporting, and consistency of comparison in making the changeover at a year-end date. The court's opinion states that restitution should cover any "amounts heretofore charged" (Williams, p. 98) improperly. This is an indication that the court intended the change to be made as of the time they issued their opinion. However, we believe they would have no objection to

<sup>3/</sup> These were not joint or agreed-upon presentations. Rather, each party presented its own figures.

carrying out the adjustment at the end of that year on the basis of the consideration we have just mentioned.<sup>4/</sup>

Accordingly, on the basis of the figures set out in Appendix A, we find that Transit should have amortized \$1,882,791 of the acquisition adjustment account in the period between January 1, 1964, and December 31, 1968. Further, on the basis of the figures set out in that same Appendix, we find that Transit actually amortized \$997,805 in the same period. Hence, we will direct that \$884,986, the difference between these two figures, shall be placed in the court-ordered reserve.

We take this action, i.e., placing the entire difference in the court-ordered reserve because it is explicitly and unequivocally directed in the court opinion. Williams, p. 98. However, we are constrained to say that this treatment is based on a faulty premise and may not be what the court actually intended. Let us explain. We have found above that in the five-year period, 1964-1968, Transit should have amortized \$1,882,791 of the acquisition adjustment account. In fact, it only amortized \$997,805. Now each dollar amortized has the effect of raising Transit's reported income by that amount. We are saying, therefore, that in the 1964-1968 period, Transit should have reported income \$884,986 higher than it actually did report. The court directs that this entire amount of previously "unreported" income be placed in the court-ordered reserve. However, this treatment contains the unspoken premise that each and every dollar not previously "reported" is excess income. However, the fact is that in both 1967 and 1968, Transit suffered losses. The company would still have suffered such losses if its income had been reported in accordance with the new and proper amortization method. See Appendix B. Also, in 1965 and 1966, as shown in the same appendix, the net incomes, using proper acquisition adjustment amortizations fell between \$300,000 and \$400,000. Comparing these returns with those shown on Appendix B which have been determined herein to be the ones which are fair and equitable, we are able to conclude that actual earnings were below the allowable earnings since the fair rates of return for these two years were in excess of \$400,000 annually. Thus, only in 1964 did the company experience excess earnings after the adjustment for proper handling of the acquisition adjustment write-off. However, as previously noted, the court's directive is explicit and unequivocal, unlike the discussion of excess return (see pp. 20-33, *infra*). Hence, we have followed that directive.

---

<sup>4/</sup> We presently have a Transit rate case pending. We will, of course, use the new and proper amortization method in computing the projected financial results for the future annual period in that case.

For annual reporting purposes, Transit will also be expected to use the new method for 1969.

#### IV

#### DEPRECIATION RESERVE DEFICIENCY

We come now to the issues involving the deficiency in the depreciation reserve. In July of 1963, the Commission engaged an independent consultant to make a full scale depreciation study of Transit's operating properties, other than buses. The results of that study were embodied in our Order No. 381. There, the Commission found, on the basis of the independent study, that there was a deficiency in the depreciation reserve of \$1,223,099. The deficiency arose because insufficient depreciation had been taken on operating properties other than buses in earlier years. The order provided that the reserve should be adjusted to the proper level as of January 1, 1964. However, no decision was made at that time as to how the deficiency should be made up. Hence, the offsetting entry was charged to a Depreciation Adjustment Suspense Account. In Order No. 564, the Commission undertook to dispose of the balance in the suspense account which remained after salvage credits. The Commission directed that a portion of the balance, amounting to \$806,168, be charged against the then-existing riders' fund which arose out of the court decision in *Bebchick v. PUC*, 318 F2d 187 (D.C. Cir. 1963) cert. denied 373 US 913 (1963). The remaining balance was attributable to properties which were put below the line following completion of the study.<sup>5/</sup> The Commission felt that charging that portion of the deficiency to the riders' fund was not appropriate.

In the Court of Appeals, protestants took issue with the charge of \$806,168 to the riders' fund. They argued, and this was their only argument on this item, that the deficiency should not be made up by a one-time charge to the riders' fund but should be amortized over the remaining lives of the properties in question.

The court rejected this argument of protestants, ruling that a one-time charge against the riders' fund might be proper. However, the court raised an additional issue not suggested by protestants. The court pointed out that we had "made no finding as to whether Transit's investors have received remuneration for the depreciation undercharges from actual earnings over and above the fair return while the properties were in service." Williams, p. 57.

---

<sup>5/</sup> The balance so treated was \$293,459. In the Court of Appeals, Transit disputed the Commission's treatment of \$252,688 of that balance.

We are to permit Transit to retain only that portion of the deficiency as to which Transit's "investors have not been compensated in the form of past earnings in excess of fair returns." Williams, p. 98. The court did not agree with our treatment of the \$252,688 deficiency relating to properties put below the line following completion of the depreciation study. The court stated that Transit was entitled to reimbursement of this amount, which arose while the properties were in service, despite the later disposition of the property, provided, of course, that as with the other amount, Transit had not already been reimbursed by "past actual earnings over a fair margin of return while the properties in question were in service." Williams, p. 62. The court remanded the matter to us to make findings on this question and for "a disposition consonant with justice to all concerned." Williams, p. 62.

At the remand hearings, protestants took the position that the difference between the book value of certain Transit properties and their fair market value on the date they were transferred to below-the-line status should be considered as actual earnings over and above a fair return within the meaning of the court's directive. Protestants urged that the amount of compensation thus determined exceeded the amount of the deficiency. Hence, they argued, the entire \$806,168 charged to the earlier riders' fund should be restored to the riders' fund here. Protestants urged no other basis on which it could be said that Transit's investors had been reimbursed for the deficiency.

Transit argued on remand that the theory of reimbursement relied on by protestants was not consistent with the test of compensation set forth in the court's opinion. The company pointed out that the court had referred to "actual" earnings and that the gains referred to by protestants were unrealized and theoretical. It was Transit's position that the figures to be considered were a comparison of Transit's actual revenues, expenses, and net operating income with the amount of return authorized by the Commissions regulating it. Such a comparison, said Transit, shows that Transit did not receive earnings over and above a fair return to compensate it for the deficient depreciation expense.

That, then, lays out the matter as it now stands before us. We must make findings "as to whether Transit's investors have received remuneration for the depreciation undercharges from actual earnings over and above fair return while the properties were in service." Williams, p. 57. The first question to be resolved is the validity of protestants' theory of reimbursement and we turn now to a consideration of that question.

We begin by emphasizing our role in this proceeding. The matter is before us on remand from the court. The court has thoroughly and exhaustively reviewed our prior actions and found them deficient in certain respects. It has, therefore, assigned us certain additional tasks, spelling out its wishes in careful language, so that a just and equitable final disposition of the matter can be made. We are, in short, acting in response to the court's directive and our first concern should be to discern and carry out their intent. Hence, we begin our inquiry by examining the court's expression of its views on this matter.

We note that the court discussed the subject matter concerning which it wished inquiry to be made no less than five times -- at pp. 57, 58 (In fn. 188), 61, 62, and 98 of the slip opinion. In almost every instance, the court uses substantially the same formulation, i.e., an excess of actual earnings over a fair return. We think that the repeated use of the word "earnings" is significant. The phrase is generally understood to refer to the operating results of a business as reflected in its income statement. We believe that the court's use of the phrase clearly conveys an intent that the Commission examine the company's records for each year to determine the income earned after all proper expenses are deducted from revenues. Moreover, we find significant the court's directive to compare "earnings" with a fair return. This is a very frequent undertaking in the regulatory process. A company's operating results, as reflected in its properly audited income statement, are compared with the return authorized for it and decisions as to action on earnings levels are made. This court is thoroughly familiar with regulatory procedure and with accounting concepts. Its use of this terminology is most significant. We think that if it had intended that we examine any factors other than the company's operating results in considering reimbursement, it would have made its intention plain.

This conclusion is reinforced when we examine the court's opinion further. In directing that we consider the comparison between earnings and a fair return, the court relied specifically on the Baker case. Washington Gas Light Co. v. Baker, 188 F2d 11 (D. C. Cir. 1950), cert. denied, 340 U.S. 952 (1951). That was another case in which the Commission and court were concerned with inadequate depreciation charges and there, also, the court held that the Commission was required to consider the possibility of other compensation for the inadequacy of depreciation charges. However, the court's discussion, and its supporting reference to a Commission decision (see fn. 42 of the Baker decision, 188 F2d 11, 21) make it clear that the court there contemplated a comparison of the earnings record, based on operating results, with the fair rate of return.

Moreover, in Footnote 188 of the Williams case, the court sets forth its most specific discussion of the inquiry it had in mind. It points to a study made of return earned by Transit and its predecessors over a 28 year period. The court makes no suggestion that this comparison of operating results with authorized returns was not the type of inquiry it expected us to make on remand. Rather, it said that such a comparison must be made for the "particular periods the properties insufficiently depreciated were in service...." Williams, p. 58, fn. 188.

Perhaps the most convincing indication that the court did not intend us to take the approach urged upon us by protestants is the court's treatment of the \$252,688 deficiency attributable to property placed below the line subsequent to the depreciation study. The Commission had refused to charge this amount to the riders' fund. The court held that this ruling was in error. "There is no disabling connection between a deficiency in past years' depreciation and the fact that the property giving rise to it is subsequently withdrawn from public use," says the court. Williams, p. 62. Here the court was dealing with the effect of placing property in below-the-line status. It was this very type of transaction that protestants relied upon in arguing that Transit's investors had been reimbursed. The court took no account of the possibility that the change of status might give rise to gain which would obviate the need to make up the deficiency. Rather, it directed us to compare "past actual earnings over a fair margin of return while the properties in question were in service." Williams, p. 62. Surely, if the court had contemplated a theory of reimbursement at all resembling that now urged by protestants, it would have given some indication of that fact in dealing with this item. Instead, it ruled in Transit's favor on the treatment of depreciation reserve deficiency on property transferred below the line and directed our attention only to a comparison of earnings and fair return.

It is significant in this regard that the court was not unaware of the excess of market value over book value of the below-the-line properties. In their brief before the court, protestants had strongly urged the court to take these amounts into account in considering the adequacy of the return earned by Transit's investors. We simply cannot believe that in an opinion as carefully drawn as this one, where the court had had the subject of possible gains on below-the-line properties specifically brought to its attention, albeit in connection with another point, that it would have confined its directive so carefully to the consideration of earnings compared with return had it not intended us to confine our inquiry to that

subject. Since we are acting specifically to carry out the court's expressed intent, we do not feel that we can properly go beyond the bounds of the inquiry they have laid out.

While we feel that our actions are constrained by the court's express directives, we have not confined our consideration simply to an attempt to ascertain what the court had in mind as the appropriate subject for inquiry. Hence, we now turn to protestant's argument itself. Protestants are perfectly candid about the essential nature of their contention. At pp. 23-24 of their brief, they plainly state their position that there was, in fact, no deficiency in the depreciation reserve. Thus, their position here is nothing less than a collateral attack on Order No. 381. That order has been a final one for at least five years. Protestants never sought reconsideration of it and never attempted to appeal it to the courts. In fact, they did not even question it when they appealed our action in Order No. 564 charging the riders' fund on the basis of Order No. 381. Protestants at that time accepted the fact that there was a deficiency in the reserve and their only quarrel was with the timing of making up that deficiency.

The principle of finality of administrative orders is firmly rooted in the law. Nor is it unsupported by considerations of sound administration. It seems basically unfair to permit one aspect of one order to be reopened in a collateral manner not contemplated by applicable law for the purpose of crediting a rider's fund while ignoring the possibility that there may well be other orders which, if similarly attacked, might lead to a countervailing conclusion.

It should be pointed out that the court itself did not reopen the question to which protestants address themselves. The court did not rule that there was not, or might not be, a deficiency in the reserve. They accepted the premise that a deficiency existed and directed an inquiry only into whether the possibility of earnings in excess of a fair return might have compensated the investors for the depreciation undercharges.

Turning now to an examination of protestant's theory on its merits, they claim, as previously noted, that there was no deficiency in the depreciation reserve. They base this claim on the argument that, when certain properties were placed in below-the-line status, the reserve should have been credited with the gain represented by the excess of market value over unrecovered cost. Their theory is subject

to question. First, protestants claim that the Uniform System of Accounts calls for a credit to the depreciation reserve of the "gain" represented by the excess of fair market value over unrecovered cost on the occasion of transfer to below-the-line status. Protestants did not specify to which Uniform System of Accounts they had reference in making this claim. However, we have reviewed the Uniform System of Accounts which actually governed Transit at the time the transfers in question were made. That System was the specific subject of the D. C. Public Utilities Commission in 1946 (PUC Order No. 3087). It provides in pertinent part:

"When property other than land, the cost of which has been charged to the accounts of this classification, is removed from service but retained by the company, the appropriate accounts of this classification shall be credited with the amount at which such property stands charged therein and balance sheet account 404, Miscellaneous Physical Property, concurrently charged with a like amount. Concurrently, balance sheet account 443, Accrued Depreciation - Road and Equipment, shall be charged and balance sheet account 445, Accrued Depreciation - Miscellaneous Physical Property, shall be credited with the appropriate amount."

"When the use of land in transportation service or in operations incident thereto is discontinued and the land is retained in possession of the company, the appropriate account in this classification shall be credited with the amount at which such land stands charged therein and concurrently this amount shall be charged to balance sheet account 404, Miscellaneous Physical Property." (D.C. PUC, Order No. 3087, issued September 23, 1946, "In the Matter of Capital Transit Company - Adjustment of Road and Equipment Accounts, Establishment of Continuing Property Records, Revision of Uniform System of Accounts for Street Railways and Allocation of Reserve for Depreciation to Various Classes of Property." Appendix A, pp. 2, 3)

Thus, the treatment which was accorded the depreciation reserve upon the transfer of these properties was directly in accordance with the specific provision of the Uniform System of Accounts governing this company. That System had been in effect for many years prior to the transfers in question. It was established by a formal Commission



order which had been subject to the process of review. If we were to accept protestants' theory, we would, in effect, be reversing the treatment of the reserve called for by the rules which governed the accounting entries to be made at the time the transfer actually took place. We would be saying, in effect, "You complied with the rules applicable to you at the time of your actions but we now think a different rule should govern and you must refund to riders the sums to which you would not be entitled under the new rules." Such an action does not comport with basic principles of sound and orderly administration and regulation, nor with principles of equity and fairness.

Moreover, it seems perfectly clear that the court has already rejected protestants' approach. In our discussion of ascertaining the meaning of the court's directive, pp. 13-14 supra, we have already noted the court's treatment of the \$252,688 portion of the deficiency allocable to certain below-the-line properties. That aspect of the court's decision has even more significance, however. To review the facts, briefly, the balance of the deficiency at the time the Commission issued Order No. 564 was \$1,099,627.<sup>6/</sup> The Commission did not apply this entire amount to the then-existing riders' fund, however. A portion of the properties on which the deficiency had been found to exist had, subsequent to Order No. 381, been transferred to below-the-line status. The Commission, in Order No. 564, directed that that portion of the deficiency which was allocable to these properties should not be charged against the riders' fund.<sup>7/</sup> If protestants' theory were acceptable to the court, this treatment would certainly have been upheld. The "gain," in the form of excess of market value over unrecovered cost, which would be recognized under protestants' theory would, according to protestants' figures concerning the properties in question, have exceeded the amount of deficiency allocable to these properties. The court was, moreover, aware of the fact of the "gain," although possibly not the amount, because protestants had pointed out its existence in another context in arguing their appeal. Nonetheless, the court overturned the Commission's treatment of this amount. It pointed out that the deficiency in depreciation had occurred while these properties were devoted to public service. Williams, p. 62. This being so, said the court, "There is no disabling connection between a deficiency in past years' depreciation and the fact that the property giving rise to it is subsequently withdrawn from public use. The charge for depreciation is generated while the property is consigned to the public weal, and is not eroded by what is done with it thereafter."

<sup>6/</sup> WMATC Order No. 564, p. 18

<sup>7/</sup> WMATC Order No. 564, p. 19

Williams, p. 62. This is, in practical effect, a direct rejection of protestants' theory. That ruling was made in the very opinion remanding the case to us and its force upon us can hardly be overstated.

Having examined protestants' theory of compensation from all sides,<sup>8/</sup> then, we are brought to the conclusion that, in making a "finding as to whether Transit's investors have received remuneration for the depreciation undercharges from actual earnings over and above fair return while the properties were in service." (Williams, p. 57) we should not consider the "gain" represented by the excess of market value over unrecovered cost of properties transferred to below-the-line status.

Rather, compliance with the court's mandate requires that we examine the company's operating results for the period while the properties in question were in service and compare their earnings, i.e., their revenues less their expenses, with the fair return authorized for them in the same period. Protestants have not seen fit to present any evidence with regard to this subject, confining their presentation to the figures relating to below-the-line properties. However, both the staff and the company have presented figures on earnings and fair return. Both presentations demonstrate that, during the period since August 15, 1956, when the present investors took over Transit, there have been no earnings in excess of a fair return which compensated Transit's investors for the depreciation undercharges. We believe that Staff Exhibit #1, Schedules 2 and 3,

---

<sup>8/</sup> There are certain less sweeping but nonetheless serious flaws in protestants' theory which we have not taken time to discuss in detail. For instance, they assume that the entire "gain" will be realized, ignoring the possibility of taxes, brokerage fees and other possible items which might reduce the gain. Also, they ignore the possibility that an examination of the reserve allocable to below-the-line properties prior to a decision that such properties are no longer needed in transit operations, might have led to the conclusion that there had been depreciation undercharges on such properties. This would affect the unrecovered cost side of protestants' equation.

summarize the pertinent history most clearly and succinctly and we have attached them hereto as Appendices C and D. They are hereby adopted as our findings on the subject of actual earnings compared with fair return during the period while the properties were in service.<sup>9/</sup>

---

<sup>9/</sup> Appendix D computes fair return in two alternative ways for certain periods. For purposes of findings on the subject of the depreciation reserve deficiency, we have not made a choice between the alternatives. It is unnecessary for two reasons: a) under either alternative, the company has not had earnings in excess of a fair return when the figures for the entire period since August 15, 1956, are combined on a net basis, as we think is proper; b) if there were excess earnings for the period covered by Orders Nos. 245 and 564, the excess would be placed in a riders' fund in any event and could not be considered excess in connection with the depreciation deficiency.

## EXCESS EARNINGS

The court set aside the Commission's determination of the appropriate level of return in both cases which were before it. The first of these cases involved the fares authorized by our Order No. 245, as further amplified by Order No. 563. These fares were in effect from April 14, 1963, until January 26, 1966. The second case involved the fares authorized by Order No. 564, which were in effect from January 27, 1966, until March 14, 1967. The court's reasons for setting aside the Commission's return determinations need not be detailed at this juncture. The important aspect of their opinion is the discussion of the disposition to be made in light of their action setting aside our own determinations.

The court took up Orders No. 245 and No. 563 first. They first determined that the case should not be remanded to us for the entry of a new rate-setting order. Williams, pp.28-31. They then found that "Transit must be compelled to make appropriate restitution for the increased fares it collected." Williams, p. 32. However, the court felt that the amount of restitution should be determined in accordance with equitable considerations and that the basic question was whether it would give offense to equity and good conscience to permit Transit to retain the revenues it had received.

In order to meet these standards, the court directed that Transit should "restore the amount realized by the fare increase only to the extent that its actual return is not reduced to an amount which all parties have agreed would be unreasonably low. Thus, Transit will be permitted to retain any portion of the higher fares necessary to preserve its actual earnings during the years in question at the level conceded by the protestants to represent a fair return." Williams, p. 40. Any excess earnings over and above this amount are to be credited to the court-ordered reserve.

The court at a later point in its opinion took up the disposition to be made in connection with Order No. 564. In that order, the Commission had found that the fares then in effect would not provide revenues sufficient to allow the company a fair return. However, instead of raising fares, the Commission directed that \$1,360,000 in a previously existing court-ordered reserve be taken as income during the year following its order. As previously noted, the court

set aside the Commission's rate of return determination and the consequent transfer of \$1,360,000 from the court-ordered reserve. The court then turned to the question of disposition. Again, it held that a remand for the entry of a new rate-setting order was inappropriate. Williams, p. 95. The court then pointed out that there were "substantial indications in the record that it would be inequitable to compel Transit to restore the entire amount it obtained from the reserve." Williams, p. 95. Accordingly, said the court, "Transit will be permitted to retain any portion of the funds transferred to it from the court-ordered reserve which is necessary to preserve its actual earnings during the period covered by Order No. 564 at the level conceded by protestants to represent a fair return." Williams, p. 97.

At the hearings on remand, there were a number of points at issue between the parties. There were, first, a number of questions as to the proper method of computing Transit's actual operating results during the years covered by Orders Nos. 245 and 564. Transit contended that certain adjustments should be made to the reported operating results, some on the basis of directives issued by the court, such as the impact of the court's directives in the Williams decision on the subject of the acquisition adjustment account and the treatment of the depreciation reserve deficiency. Others involved Commission-directed adjustments involving tax treatment of the track removal reserve and a special credit arising out of our Order No. 773. Protestants disagreed with most of these proposed adjustments. Hence, there was dispute as to the amount of actual earnings in the years covered by Orders Nos. 245 and 564.

There was also dispute as to the level of earnings conceded by protestants to represent a fair return. Williams, pp. 40, 97. Protestants took the position that the level in question was the straight dollar figure testified to by protestants' witnesses in the two proceedings, i.e., \$1,107,000 in the case of Order No. 245 and \$1,550,000 in the case of Order No. 564. Protestants computed the return authorized by allowing this dollar amount for each year, or an aliquot portion for a part of a year, that the orders were in effect.

Transit took the position that protestants had conceded that Transit should recover its actual interest expense plus a dollar return on equity of a certain amount. Transit, therefore, computed its actual net operating income, deducted therefrom its actual interest expense, and compared the remaining balance with the allowance of the fixed return on equity which it alleged that protestants had conceded.

Both parties and the staff also presented computations based on the theory that the concededly fair level of return amounted to the actual interest expense plus a return on equity of 12%, this being the level of return on equity conceded by protestants' witness to be fair. Protestants, however, urged that a portion of the book equity, allocated to non-transit assets, be deducted from the equity figure to which the 12% should be applied.

Finally, there is a serious dispute as to whether, in computing the excess earnings, the entire period covered by both Orders Nos. 245 and 564 should be considered as one unit or whether each order period should be considered separately. This is clearly the most important issue in the area of excess earnings and we shall take it up first.

It is quickly apparent why the issue is so important. It is clear that in the period covered by Order No. 245, Transit had earnings in excess of the level conceded by protestants to be a fair return. After the various questions as to both actual earnings and the conceded level of fair return are resolved (see pp. 29-33 , *infra*),<sup>10/</sup> the excess in the Order No. 245 period amounts to \$841,312. On the other hand, it is equally clear that in the period covered by Order No. 564, Transit's earnings were drastically under the level conceded to be fair. Again after resolving various questions on actual earnings and fair return, the deficit in the period covered by Order No. 564 amounts to \$1,202,215. Thus, if each period is considered separately, we would conclude that the sum of \$841,312 should be placed in the court-ordered reserve -- this being the excess earnings in the period covered by Order No. 245. As to the period covered by Order No. 564, we would simply say that there were no excess earnings and hence nothing to be placed in the court-ordered reserve. If, however, we consider the two periods together, we would conclude that there are no excess earnings to be placed in the court-ordered reserve because the company's actual earnings for the total period were less than the level conceded by protestants to be a fair rate of return.

We confess that resolution of this issue has proved extremely difficult for us. We should say at the outset that our endeavor in this proceeding has been to carry out the basic intent and express directives

---

<sup>10/</sup> No matter how the various questions are resolved, there would be an excess in the period of Order No. 245 and a deficiency of a greater amount in the period of Order No. 564. The only question is as to the amount thereof.

of the court in the task it has assigned to us on remand. In considering this and all other questions presented to us on remand, we have given the court opinion the most thorough and careful study we can in an effort to ascertain the court's own intent.

That study was most difficult on this question of "netting-out" the two periods. The difficulty arises out of the fact that we find in the court's discussion two lines of thought which pull us in opposite directions.

There are, on the one hand, indications in the court opinion that it contemplated that the restitution issue for the period covered by Order No. 564 would be limited to determining how much of the amount transferred to Transit from the old riders' fund could properly be retained by Transit. Thus, on p. 95 of the Williams opinion, the court said:

"[w]e hold that its action in ordering \$1,350,000 to be transferred from the court-ordered reserve was unlawful and must be set aside...However,...we encounter substantial indications in the record that it would be inequitable to compel Transit to restore the entire amount it obtained from the reserve." [Emphasis supplied]

Again, on p. 97, the court said:

"Transit will be permitted to retain any portion of the funds transferred to it from the court-ordered reserve which is necessary to preserve its actual earnings during the period covered by Order No. 564 at the level conceded by the protestants to represent a fair return." [Emphasis supplied]

Finally, on p. 99, the court said,

"The funds so transferred [from the reserve] shall be restored to the reserve, except that Transit may retain any portion thereof necessary to preserve its net income at the level recommended by the protestants as a fair return." [Emphasis supplied]

These repeated statements suggest to us that the court contemplated that a determination that Transit could retain all of the funds transferred to it from the reserve would end our consideration of restitution under Order No. 564.

On the other hand, there is nothing more clearly spelled out, repeated, and emphasized in this opinion than the court's intention that the question of restitution be settled in accordance with equitable considerations.

When it turned to determination of criteria by which the amount of restitution would be measured, the court's very first statement was that its "decision in this regard is to be governed by the equitable considerations which apply to suits for restitution generally." Williams, p. 35. The basic question is whether "the money was obtained in such circumstances that the possessor will give offense to equity and good conscience if permitted to retain it...." Williams, pp. 35-36. Restitution, said the court, "is not a matter of right but is 'ex gratia, resting in the exercise of a sound discretion.'" Williams, p. 36. Hence, the court held, it could "direct restitution in an amount less than the whole sum of the increased fares collected under the invalid order, or...deny it altogether, if compelling equitable considerations so dictate." Williams, p. 36. The court also said:

"Nevertheless, we see no obstacle to our permitting the company to retain some, though not all, of the proceeds of the fare increase if there is reliable evidence suggesting that it would be inequitable to compel restitution in a greater amount. '[R]estitution is granted to the extent and only to the extent that justice between the parties requires.'" Williams, p. 36, fn. 106.

In addition, there are numerous other references to "equity" and "fairness" in the court's discussion of its disposition of this matter. See e.g., Williams, pp. 36, 37, 38, 39, 40, 41, 95.

Finally, and most explicitly, the court said:

"[w]e are unable to see how any proper resolution of the matter of restitution in the circumstances presented could ignore the reality of Transit's financial experience during the years in question." Williams, p. 40.

If these principles of equity and good conscience are applied to the question whether the total period covered by Orders Nos. 245 and 564 should be considered as a whole, there are compelling reasons why this consolidated treatment should be required.



First, there seems to be a basic inequity in telling a company that it must restore a sum of \$841,312 to the riding public because the riders paid this amount of excess earnings in one period while in the same proceeding, on the basis of the same court action, it unquestionably appears that in the very next succeeding period, the company not only did not earn an excess return, it failed to earn enough over its operating expenses to pay the interest on its debt. The results, in terms of the reality of Transit's financial experience, is anomalous and should give pause to anyone trying to do equity.

Our doubts as to the equity of considering each period separately were reinforced when we considered the history of the period covered by Order No. 564. That period began on January 27, 1966, and ran until March 14, 1967. Toward the end of that period, on October 17, 1966, Transit filed an application seeking a rate increase. After hearings on that application, this Commission on January 14, 1967, entered its Order No. 656. That order granted the company an interim rate increase which would have been sufficient only to permit the company to recover its operating expenses and interest for the period required by the Commission to consider the proper level for the rate of return. An appeal was taken from this order and on January 28, 1967, the court stayed its effectiveness. From that date until March 15, 1967, the company was required to charge the fare authorized by Order No. 564 rather than the higher fare authorized by Order No. 656. The company's operating results in the three months of January, February, and March of 1967 were adverse in the extreme. Figures in the record of this proceeding show that the operating revenues fell short even of meeting operating expenses by \$492,217. Over and above this amount, \$277,529 of interest expense was not covered by revenues, making a total loss, for the period from January 1, to March 14, 1967, of \$769,746. In the period from January 28 thru March 14 alone, when Order No. 656 was stayed, the loss amounted to \$569,977. However, in Payne v. WMATC, D. C. Cir. No. 20,714 decided October 8, 1968, the Court of Appeals held that Order No. 656 was perfectly valid and proper and that the stay thereof should not have been granted by the court.

The implications of these facts are startling. We are considering whether, for the purposes of restitution, the periods covered by Order No. 245 and Order No. 564 should be considered as a whole or as two separate parts. The court has made it crystal clear its objective in considering restitution; it wishes to do what justice and equity require. Yet, if we consider the two periods separately, we would be ignoring the fact that a large part of those losses occurred during a period when a Commission order which would have avoided, or at least

vitiated, those losses had been stayed by the court -- an action which the court itself has later said it should not have taken. We simply cannot believe that adopting such a view is consistent with the court's expressed desire to do what justice and equity require.

Of course, justice and equity also require that the interest of the ratepayer who has paid excessive charges in any period be considered and we have carefully weighed that interest. However, the facts are these. The excessive return earned during the period covered by Order No. 245 amounted to \$841,312. (See p. 33 infra) During that same period, the total operating revenues amounted to \$88,259,367, about 94% of which were farebox revenues. Thus, the revenues which eventually turned out to be excess amounted to about 1% of the total farebox revenues. Put another way, if the return had been kept at the level conceded to be fair, the total farebox revenues required would have been reduced by only 1%. A 1% reduction in a typical D. C. fare at that time would have amounted to about 2.5 mills. A person who rode a bus ten times a week would have paid an excess of about \$1.25 per year during the 2 3/4-year period that Order No. 245 was in effect. While not defending this excess payment, it must be weighed in the balance with the fact that the rider was not required to pay an increased fare of substantial size so that the company could cover its operating expenses and interest during the period of Order No. 564 and, indeed, with the fact that the rider was saved from an actually authorized fare increase of 2 1/2 cents per ride for a period of over six weeks by a stay which the court later held was unnecessary.<sup>11/</sup> We should make our point clear. We are not defending the excess return during the period of Order No. 245 on the ground that it imposed little burden on the riding public. Rather, we are saying that the size of the burden is a factor to be weighed in the equitable consideration of restitution.

Returning to our original inquiry, we are attempting to determine whether the two periods of Orders Nos. 245 and 564 should be considered separately or as a whole. We have looked for the answer in the court's directives to us. We have found, on the one hand, indications in the court's language specifically dealing with Order No. 564 that they were thinking of treating that period as a separate one. We have found, on the other hand, that the court's basic concern was with doing what justice and equity require and that justice and equity strongly indicate that the two periods should be considered together.

<sup>11/</sup> The same rider of ten times per week (See p. 26, supra) who would have overpaid about \$1.25 per year during the 2 3/4-year period of Order No. 245, saved \$1.50 during the six-week period when Order No. 656 was stayed.

Having weighed these conflicting considerations long and carefully, we have decided that we must decide in favor of considering the two periods together. We feel, first, that the court's concern with equitable treatment is the more basic concern and must be given the greater weight by us. Second, we feel that we must not take too literally the court's specific language indicating that restitution in Order No. 564 is limited to considering how much the company may keep of the funds transferred to it from the court-ordered reserve. In making those statements, the court was obviously not aware of the operating results actually experienced by the company in the Order No. 564 period. See, for example, footnote 339 of the Williams opinion which indicates that the court believed that Transit had had net operating income in 1966 of approximately \$1,978,000. The company's actual net operating income in that year was \$1,483,580. If the court had been aware of this fact, it might very well not have used the specific language to which we have been referring.

Only one more point with regard to this "netting out" issue need be discussed. Protestants argued that there was a legal impediment to considering the two periods together, contending that this constituted "retroactive rate-making", a practice condemned by the law. We cannot accept this view. We are not setting rates in any way in this proceeding. We are simply dealing with a court decision which has set aside two Commission orders and has directed that restitution which is required by justice and equity. If justice and equity require that the periods in question be considered as a whole, that has nothing to do with retroactive rate-making. It is simply a question of appropriate restitution.

For all these reasons, we have determined that, in measuring the amount of restitution to be made as a result of the setting aside of the rate of return determinations in Orders Nos. 245 and 564, Transit's actual financial experience during the entire period covered by both orders should be considered as a whole. That actual experience should be compared with the return conceded by protestants to be fair during the same consolidated period. When this is done, the conclusion is reached that there were no excess actual earnings during the period and, hence, nothing to be placed in the court-ordered reserve.

Before making findings on the specific figures as to actual earnings and the conceded level of fair return, however, certain other issues must be resolved. We shall take up next the issues involving the computation of actual operating results.

All parties start with the reported operating results and all accept an adjustment relating to income taxes in connection with cost of track removal. However, there are two additional adjustments suggested by Transit which protestants do not accept. First, the Williams decision requires that changes be made in the method by which the acquisition adjustment reserve is to be amortized in each of the years beginning with January 1, 1964. Transit argues that the proper new method of amortization should be determined and that the new method should then be applied to the reported operating results for the periods since January 1, 1964. To accomplish this, the amount previously amortized in that period is removed from the reported results and the amount which should have been amortized is substituted therefor. Protestants reject this adjustment, arguing that this is not the way in which the court directed us to give effect to the change in amortization method required by the court. For the reasons we discuss at pp. 6, 10, supra, we believe that protestants are correct on this point and we reject this adjustment.

Second, Transit adjusts the reported results for the periods covered by Orders Nos. 245 and 564 to reflect the effect of the court's directive concerning treatment of \$252,688 of depreciation reserve deficiency which is allocable to certain properties transferred below the line. The court said that this \$252,688 must be given the same treatment which is decided to be proper for the \$806,168 balance of the deficiency. Protestants reject this adjustment on the basis of their argument that Transit's investors have been compensated for the deficiency and hence no adjustment is needed. For the reasons discussed at pp. 17-19 supra, we have determined that the investors have not been compensated for this deficiency and, hence, we must make an adjustment for the \$252,688 amount. Therefore, we will accept the treatment accorded this item by both Transit and the staff.

Having made these determinations, we can set out Transit's actual financial experience for the periods of Orders Nos. 245 and 564: <sup>12/</sup>

---

<sup>12/</sup> The operating statements for which these figures are based are attached hereto as Appendix E.

TABLE 1

	4/14/63 - <u>1/26/66</u>	1/27/66 - <u>3/14/67</u>	Cumulative 4/14/63 - <u>3/14/67</u>
Net operating income before adjustment	\$4,645,910	\$997,476	\$5,643,386
Track removal tax adjustment	(96,731)		(96,731)
Reduction of court-ordered reserve to comply with <u>Williams</u> decision on depreciation reserve deficiency	<u>(18,000)</u>	<u>(234,688)</u>	<u>(252,688)</u>
Adjusted net operating income	<u>\$4,531,179</u>	<u>\$762,788</u>	<u>\$5,293,967</u>

There remain the issues involving determination of the level of return conceded by protestants to be fair. There is, first, the protestants' theory on this point. It is simple and straightforward. They take the specific dollar figure testified to by their witness in the proceedings before the Commission, annualize it for the period of the order, and contend that this total dollar figure is the conceded level of return. Thus, for Order No. 245, the specific figure testified to was \$1,107,000 and the order was in effect for two full years and 79.8% of a third year. Hence, protestants say the total proper return was \$3,087,423.<sup>13/</sup>

We think this theory is unacceptable. It assumes that the proper return for each year is a single fixed figure. If the return is thus fixed, it follows that as interest expense rises, the return on equity must go down. Yet, protestants' witness never espoused such a theory. His determination of return was based on the assumption that interest expense must be covered and that a return on equity of a determined percentage over and above interest was proper. There is nothing in his testimony to suggest that he would not increase the dollar return figure if interest were shown to have increased. Moreover, the court itself indicates that increasing the total return in these circumstances is proper. It directs its attention to the return on equity component of the return determination, thus impliedly accepting the

$$13/ \quad \$1,107,000 \times 2.798 = \$3,087,423$$

premise that interest must be covered and a return on equity of a given level over and above interest be allowed. See, e.g., Williams, p. 96.

Hence, we reject protestants' theory as to the conceded level of return and turn to the alternatives discussed in the remand proceedings.

There is first the theory on which Transit places primary reliance. They start with the presumption that the protestants' witness would certainly allow a return sufficient to cover actual interest expense. They then set out the amount of such expense for each year. They then accept the specific dollar return on equity which protestants' witness allowed in his testimony as the conceded level of fair return on equity. Thus, in Order No. 245, protestants' witness allowed a total dollar return of \$1,107,000 composed of \$602,089 of estimated debt expense and a return on equity of \$504,911. Williams, p. 14, fn. 47. This latter figure is relied upon as the conceded fair return on equity for each year that Order No. 245 was in effect. In Order No. 564, the total annual return conceded by protestants was \$1,550,000, including interest expense of \$957,000, leaving a dollar return on equity of \$593,000.<sup>14/</sup>

The second theory, on which the company, the protestants, and the staff all presented computations, assumes that protestants' witness conceded that a fair return would cover actual interest expense plus a return on equity of a given percentage -- 12% in the case of Order No. 245 and 13% in the case of Order No. 564. Protestants, however, argued that this percentage figure should not be applied to the book equity. Rather, that portion of the equity which is allocable to non-transit assets should first be deducted. The return percentage should then be applied to the remaining balance.

These, then, were the various theories put forward as to the proper method of computing the level conceded by protestants as a fair return. It would perhaps be helpful at this point to set out in a table the dollar figures arrived at by each method:

---

<sup>14/</sup> WMATC Order No. 564, p. 26

TABLE 2

	(1)	(2)	(3)	(4)
	Protestants' Fixed Dollar Theory (see <u>Appendix F</u> )	Actual Interest and Fixed Dollar Return on Equity Theory (see <u>Appendix G</u> )	Actual Interest and Percentage Return on Book Equity Theory (see <u>Appendix H</u> )	Actual Interest and Percentage Return on Portion of Equity Theory (see <u>Appendix I</u> )
1. 4/14/63 to 1/26/66	\$3,087,423	\$3,703,215	\$3,689,867	\$3,087,776
2. 1/27/66 to 3/14/67	<u>1,749,950</u>	<u>2,150,693</u>	<u>1,965,003</u>	<u>1,541,758</u>
3. Total Con- ceded Return	<u>\$4,837,373</u>	<u>\$5,853,908</u>	<u>\$5,654,870</u>	<u>\$4,629,534</u>

We will begin our discussion with protestants' theory that, if the percentage return on equity method is to be employed, a portion of the book equity allocable to non-transit assets must first be deducted. We think that this approach must be rejected on a number of grounds. First, protestants' own witnesses applied the percentage return figures to total book equity in reaching their recommendations, a fact specifically recognized by the court. Williams, pp. 13, 96. Since the court also said that the level to be used was that conceded by protestants' witnesses, it is difficult to reconcile the use of a different approach now. Second, the court, in the Payne case, specifically approved a rate of return determination of this Commission in which one element considered was the rate of return on book equity. These two considerations clash with the court's expressed intent that the amount of restitution be determined in accordance with equitable considerations. The cases here involved were decided several years ago on the basis of records in which the protestants' own witnesses accepted the validity of determining a return on the basis of book equity. Other cases, in which a similar reliance on book equity has occurred, have subsequently been decided, and one has specifically been upheld by the court. Now in considering restitution, protestants, for the first time, suggest to this Commission an entirely new theory

as to the amount of equity capital on which to base a return computation.<sup>15/</sup> This simply does not seem to us to be an equitable course of action.

Moreover, apart from these considerations, we have doubts as to the validity of the theory itself. The premise on which it is based is that the ultimate objective of a commission in a rate proceeding is to provide the company with a return on equity. This is not, of course, the case. The Commission is seeking to establish a fair rate of return on a rate base, usually net plant at original cost, in the case of traditional rate regulation, or a return on gross operating revenues, in the case of D. C. Transit and other companies regulated by this Commission. The question of return on equity arises because this Commission, like all others, uses a cost of capital approach in considering the proper level of return. The assumption is that return is a cost, like all other expenses of the company, and the objective is to determine the amount of that cost. This means that we must determine how much this company must earn on its equity in order to be competitive in the capital markets. Essentially, this involves an assessment of comparative risks. In these terms, the return on equity must be looked at in terms of the entire equity. If some of that equity is invested in non-transit uses which reduce the degree of risk, that effect will be taken into account in determining the proper level of return. In sum, the objective of our rate of return inquiry is to determine the level of return on gross operating revenues which will meet the applicable standards, such as those set out in the court's Transit I opinion. Consideration of the proper return on equity is merely a means to that end and does not mean that we are requiring the ratepayer to provide a return on capital not devoted to public use.

We are left then with a choice between the theory of a fixed dollar return on equity or the theory of a percentage return on equity. As Table 2, supra, indicates, there is little difference between the results reached by either approach. (Compare Column (2) Line 3 with Column (3) Line 3.) However, a choice must be made and we will opt

<sup>15/</sup> It is significant, moreover, that while protestants did not put forward this theory before the Commission previously, they did argue it in the Court of Appeals. Brief for Petitioners, No. 20,200, pp. 34 and 35. The court did not see fit even to discuss it.



for the percentage return on equity theory. This is more consistent with the usual means of considering the return question. It is the theory on which the court itself relied in remanding the case to us. See Williams, pp. 38, 41, 96. Hence, referring to Appendix E and Table 2, Column (3), supra, we herewith make the following findings:

TABLE 3

	<u>Actual Return</u>	<u>Conceded Level of Return</u>
4/14/63 to 1/26/66	\$4,531,179	\$3,689,867
1/27/66 to 3/14/67	<u>762,788</u>	<u>1,965,003</u>
Cumulative 4/14/63 to 3/14/67	<u>\$5,293,967</u>	<u>\$5,654,870</u>

We conclude, therefore, that there is no balance to be placed in the court-ordered reserve on the basis of the court's setting aside of the rate of return determinations in Orders Nos. 245 and 564.

## VI

### TREATMENT OF THE COURT ORDERED RESERVE

Having considered all the issues as carefully and thoroughly as we are able, we have concluded that there is nothing to be placed in the court-ordered reserve in connection with the depreciation reserve deficiency. We have also concluded that there is nothing to be placed in the reserve in connection with the setting aside of the Commission's rate of return determinations in Orders Nos. 245 and 564. Finally, we have determined that \$884,986 must be placed in the reserve in connection with the treatment of the amortization of the acquisition adjustment account.

#### A. Cash or Book Entry

This entry shall be made by means of a book entry, other than placing cash funds in escrow. The court left the determination of this question to the Commission, saying that restitution "is to be affected by placing funds in or making non-cash credits to the court-ordered reserve." Williams, pp. 97-98. On remand, protestants agreed with the company that any credits to the reserve should be in the form of book entries. We think this approach is most appropriate. The company's present cash working capital position is, we know, extremely precarious and it would be imprudent to worsen that position by placing some portion of its funds in escrow. Moreover, we note that the credit to the reserve stems from the acquisition adjustment account, which is itself a non-cash item. Accordingly, the adjustment herein ordered shall be in the form of a credit to the court-ordered reserve and a debit to the acquisition adjustment account, with no corresponding entries to a cash or escrow account.

#### B. Interest

We should take up next the question whether the court-ordered reserve should also be credited with interest on the amounts directed to be placed therein. Protestants argued that this should be done, a position disputed by Transit. In view of the determinations made in the foregoing sections, we do not think that the additional requirement of interest would be appropriate. The amounts credited to the court-ordered reserve are attributable to our treatment of the acquisition adjustment account. Insufficient amounts from this account were amortized in past years according to the theory we now adopt in furtherance of the court opinion. However, treatment

of this account involves non-cash adjustments and we do not believe that the requirement of interest thereon is reasonable. Moreover, we have already indicated our doubts concerning the treatment of this adjustment. See p. 10 , supra. Requiring the payment of interest would only compound the problem.

### C. Debits to Reserve

There is one entry with regard to the court-ordered reserve which we think should appropriately be made in this proceeding. Transit suggests that we should take into account all of the serious losses it has suffered in recent years by debiting the court-ordered reserve appropriately. We see no basis for such a general treatment of the reserve. However, there were three Commission orders which explicitly took the reserve into account in setting rates. These were Orders Nos. 880 and 882, 894 and 900. In each of these, we directly reduced the amount of fare increase which we would otherwise have granted because of the decision in the Williams case and the possibility of a court-ordered reserve which that case created. Thus, in Order No. 880, we said:

"We do feel that, at least on an interim basis, however, we should not allow for a return on equity until we have a clearer view on the issues to be resolved in the establishment of the riders' fund. Hence, that portion of the revenue requirement as previously determined. . . . which represents return on equity should now be eliminated." Order No. 880, pp. 44-45.

Our conclusions of law in that Order said in part:

"2. That the issues regarding a riders' fund raised by the opinion of the U. S. Court of Appeals in Williams v. WMATC, require that no return on equity be allowed for the time being." Order No. 880, p. 51 and Order No. 882, p. 9.

In Order No. 894, we continued to deny Transit a return on equity because of the pendency of the riders' fund issues, saying:

"We have previously noted that the fares now in effect are designed only to cover Transit's operating expenses and provide service on its debt requirements. Faced with the possibility that the company has received excess profits in the past, we feel that we have no alternative but to hold the fares at their lowest possible level. Our ultimate

responsibility is to insure the rider a complete, permanent, and effective bond of protection from excessive rates. Under these circumstances we find the existing fare structure, at least for the near future, to be fair and reasonable.

It may be argued that until a definite riders' fund is established, the company should be entitled to earn a return for the stockholders, and if a riders' fund does develop, adjustments can be made on the company's books accordingly. It cannot be denied, however, that while those monies may be subject to refund, the rider of today is not necessarily the rider of tomorrow. This is particularly true in view of the transient nature of the population of the Washington Metropolitan area. It is therefore our duty to look at the background of all these consequences and, where a choice must be made between the ratepayer and the stockholder, find for the ratepayer. We will, of course, in creating the initial level of the riders' fund take into account the period of time in which we cause the company to operate without a return on equity."

Finally, in Order No. 900, which set the fares which have been in effect since December 23, 1968, we held:

"3. That it is just and reasonable that the company receive no return on equity while the Commission considers the questions regarding the riders' fund raised by the Court of Appeals decision in Williams v. WMATC, decided October 18, (sic) 1968." Order No. 900, p. 10.

Unquestionably, therefore, the riding public has already benefited from the court-ordered reserve to the extent that it precluded Transit from receiving a return on equity since October 30, 1968, the date on which the fares authorized by Order No. 882, implementing Order No. 880, went into effect. We held in Order No. 880, that but for the court-ordered reserve, we would have allowed a return of \$746,682 on equity. Order No. 880, pp. 36, 50. Accordingly, we will debit the court-ordered reserve by that amount in this proceeding, contra-crediting Retained Earnings Account, leaving a balance of \$138,304 to be applied in the future for the benefit of the riding public.

D. Use of the Balance

This balance will be used in accordance with the court's directive. Thus, in the Williams case, the court stated: "All funds to be deposited in the court-ordered reserve are to be employed by the Commission in the manner and for the purposes described in Bebchick v. Public Utilities Commission." Williams, p. 98, fn. 337.

In the Bebchick case, the court said that the utilization and disposition of the Riders' Reserve "shall be left to the discretion of the Commission having regulatory authority with respect to Transit, provided such discretion is exercised consistently with the purpose of benefiting Transit users in any rate proceedings pending or hereafter instituted." Bebchick v. PUC, 318 F2d 187, 204 (D.C. Cir. 1963) cert. denied 373 US 913 (1963).

The Commission will follow the directive of the court and utilize the reserve in future rate proceedings ("pending or hereafter instituted") for the benefit of Transit users.

## VII

### THE INVESTMENT TAX CREDIT

The court, in its remand decision, directed the Commission "to make findings and conclusions as to the treatment proper for Transit's investment tax credits, and the amounts, if any, by which Transit's Federal income tax expense should be reduced as a consequence of any such credits. To the extent the Commission may find that Transit was permitted to accrue excessive income tax expenses for 1966, the amount thereof should be placed in the court-ordered reserve." Williams, p. 99.

All parties are in agreement that there is nothing to be placed in the court-ordered reserve in connection with this item because the Commission allowed no Federal income tax expense for 1966 in deciding Order No. 564. Therefore, the treatment of the investment tax credit had no impact upon our rate determination in that order.

The issue with regard to investment tax credit is thus limited to a determination by the Commission of the proper treatment for Transit's investment tax credits. As pointed out at p. 20 of Order No. 564, we have in the past ignored the effect of the investment tax credit in order "to comply with the intent of Congress as expressed in Section 203(e)<sup>16/</sup> of the 1964 Internal Revenue Act." The court considered the Commission to be in error "if it felt that it was inexorably bound by the injunction" of Section 203(e). Williams, p. 65. But the court did say that it would be an appropriate exercise of authority to select guidelines from policy incorporated into statutes not legally binding upon the Commission. The court made it clear that there would have to be some sign of a particularized inquiry to indicate that the Commission was exercising discretion in arriving at the decision not to consider the effect of the investment tax credit in this case. The court left the Commission with the problem of reconciling relevant tax policy with rate-making principles.

<sup>16/</sup> "...Congress does not intend that any agency or instrumentality of the United States having jurisdiction with respect to a taxpayer shall, without the Consent of the taxpayer, use --

"(2) in the case of any other property any credit against tax allowed by Section 38 of such Code,"

to reduce such taxpayer's Federal income taxes for the purpose of establishing the cost of service to the taxpayer or to accomplish a similar result by any other method."

Transit, in its brief, pleaded for a continuation of the Commission's policy of giving no effect to the investment tax credit. It argued that any other course would discourage Transit from purchasing new equipment.

Mr. Melwood W. Van Scoyoc, witness for protestants, recommended that the "tax saving realized in an accounting period through the investment credit be utilized in determining the income tax allowance in the cost of service for that year."

We have reconsidered our past policy with regard to the investment tax credit, weighing the company's need for an incentive to make capital investments on the one hand with the public's right to be protected from excessive fares on the other hand. We have concluded that any actual reduction in Federal income tax, occasioned by the operation of the investment tax credit provisions of the Internal Revenue Code, should be recognized and passed on to the ratepayer in equal annual amounts spread over the depreciable life of the assets which generated the tax credit. This has the triple advantage of (1) effectively passing on the tax credit to the consumer, (2) spreading that credit as an offset to the annual depreciation charge of the asset involved, and (3) permitting a modicum of cash-flow advantage to the carrier to assist it in its initial cash requirements accompanying the purchase of an asset.

As for Transit's argument that the past treatment of the investment tax credit by the Commission provides an incentive for the carrier to purchase new assets, some of Transit's major acquisitions i.e., its new offices and its maintenance base in Bladensburg, were committed prior to the operation of the investment tax credit rule. The acquisition of new buses has been accompanied by adjustments in depreciation rates to give effect to the planned effect upon the age of the fleet. Thus, when Transit was ordered to purchase 100 new buses each year (1/12th of the fleet), the Commission permitted a depreciation rate on buses based on a 12-year service life, and when the company was permitted to purchase only 85 buses per year (1/14th of the fleet), the depreciation provision was changed to a 14-year basis. In view of the fact that Transit has pending before this Commission a request to be excused from purchasing 85 buses per year, and in view of the fact that Transit did not meet its obligation to purchase 85 buses during the year ended June 1, 1969, it does not appear to the Commission that the promise of an investment tax credit will influence Transit to purchase new equipment. It is true that, during the past two years, Transit had no taxable income and therefore would not have been able

to utilize any investment tax credit, but the presence of other difficulties, as outlined in Transit's application for relief from the order of this Commission requiring it to purchase buses, would have relegated the entire matter of the incentive inherent in the investment tax credit to strictly a theoretical conjecture.

The Commission will order Transit to normalize any future investment tax credits over the depreciable life of the assets which have given rise to those credits. Of course, to the extent that an investment tax credit is calculated but never materializes due to the lack of an income tax against which to offset it, Transit is not to make provision for any adjustment -- tax credit adjustments will be made only in the amounts and to the extent that they result in tax savings.

## VIII

### PROTESTANTS' REQUEST FOR A FEE

In their brief, protestants' request that we retain jurisdiction in this proceeding for determination of a fee for protestants' counsel and expert witnesses. This Commission has only those powers conferred upon it by the Compact and there is no provision therein which empowers us to award fees. The protestants must look elsewhere for the determination of this question.



## IX

### SUMMARY AND CONCLUSION

In the foregoing discussion, we have reached the following conclusions:

1. The balance of \$2,519,459 in the acquisition adjustment account on January 1, 1964, should be amortized over the period ending August 15, 1976. The amount of each annual amortization amount should be related to depreciation accruals on property in service at the time the acquisition adjustment was generated. A recalculation based on this procedure determines that the amount which should have been amortized between January 1, 1964, and December 31, 1968, is \$1,882,791. The amount actually amortized by Transit during this period was \$997,805. A correcting adjustment will be ordered, requiring Transit to place the difference, \$884,986 into a special court-ordered reserve.

2. We cannot accept protestants' theory that the difference between market value and book value of certain Transit properties transferred below the line should be considered a "gain" constituting actual earnings over and above a fair return. Such a theory is not consistent with the court's directive; it is an untimely collateral attack on a final order of the Commission; it is based on a faulty premise as to the rules governing Transit at the time of the property transfers; finally, it has been specifically rejected by the court. Looking then to a comparison of operating results with authorized levels of return, it appears that since August 15, 1956, there have been no earnings in excess of a fair return which served to compensate Transit's investors for depreciation undercharges.

3. To comply with the standards of equitable treatment as expressed in the court opinion, Transit's earnings experience under Rate Order No. 245 and under Rate Order No. 564 must be considered together. The proper level at which to set the standard for a proper return is calculated on the basis of actual interest expense experienced by Transit plus a percentage return on book equity at the level indicated by protestants' witnesses in the original proceedings before this Commission. The result is a conceded proper level of total earnings for the period covered by the two rate orders, April 14, 1963, through March 14, 1967, in the amount of \$5,654,870. This amount is in excess of the actual earnings of Transit during that period, which were \$5,293,967. Therefore, no adjustment on account of this item is to be made to the court-ordered reserve.

4. The adjustment to the court-ordered reserve shall be a book entry, with no corresponding entries to a cash or escrow account. No provision is to be made for the accrual of interest on the amount adjusted.

5. The court-ordered reserve is to be debited in the amount of \$746,682, the amount of return on equity which was denied to Transit as a result of the pendency of this remand proceeding in our Order No. 880, served October 18, 1968. This leaves a balance of \$138,304 in the court-ordered reserve for future application for the benefit of the riding public.

6. Any investment tax credits which Transit may realize in the future will be passed on to the ratepayer in equal annual amounts over the depreciable life of the assets which give rise to those credits.

**THEREFORE, IT IS ORDERED:**

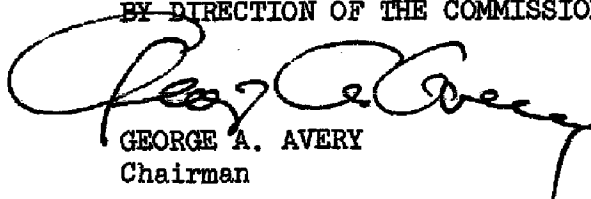
1. That a credit entry be made to an account entitled court-ordered reserve in the amount of \$884,986, with contra-debit to the acquisition adjustment account. This adjustment shall bear the date of December 31, 1968.

2. That, beginning January 1, 1969, monthly adjustments to the acquisition adjustment account shall be based on actual dollar charges for depreciation pertaining to properties acquired on August 15, 1956, providing for the complete write-off of the balance in the acquisition adjustment account by the time that all such properties as were acquired on August 15, 1956, are fully depreciated, but in no case beyond August 14, 1976.

3. That the court-ordered reserve be debited in the amount of \$746,682 with contra-credit to retained earnings account, the book entry to be dated October 17, 1969, the date of this Order.

4. That, beginning January 1, 1969, in the event Transit should earn any investment tax credit, provision shall be made on the books of Transit to normalize such credit, writing the total credit off over the depreciable life of the asset which gave rise to the credit.

BY DIRECTION OF THE COMMISSION:

  
GEORGE A. AVERY  
Chairman

APPENDIX A

COMPARISON OF THE ACQUISITION ADJUSTMENT  
WRITE-OFF BASED ON THE DEPRECIATION DOLLAR METHOD  
WITH THE ACQUISITION ADJUSTMENT ACTUALLY WRITTEN  
OFF ON BOOKS -- FOR THE YEARS 1964 THRU 1968

	WRITE-OFF BASED ON DEPRECIATION DOLLAR METHOD	WRITE-OFF TAKEN ON BOOKS	WRITE-OFF DEFICIENCY AMOUNT TO BE ADDED TO RIDERS' FUND
1964	\$ 443,173	\$ 199,561	\$ 243,612
1965	444,684	199,561	245,123
1966	353,732	199,561	154,171
1967	274,117	199,561	74,556
1968	<u>367,085</u>	<u>199,561</u>	<u>167,524</u>
Totals	\$ 1,882,791	\$ 997,805	\$ 884,986

## APPENDIX B

D. C. TRANSIT SYSTEM, INC.  
 NET INCOME FOR YEARS 1964 THRU 1968 AFTER ADJUSTMENTS  
 TO REFLECT THE ACQUISITION ADJUSTMENT WRITE-OFF BEING MADE  
 ACCORDING TO THE DEPRECIATION DOLLAR METHOD

	1964	1965	1966	1967	1968
Net operating income (loss)	\$ 1,423,716.43	\$ 1,110,558.55	\$ 1,483,579.77	\$ 1,212,549.35	\$ (383,667.61)
Deduct acquisition adjustment written off on books	(199,561.08)	(199,561.08)	(199,561.08)	(199,561.08)	(199,561.08)
Add acquisition adjustment write- off per Depreciation Dollar Method	<u>443,173.00</u>	<u>444,684.00</u>	<u>353,732.00</u>	<u>274,117.00</u>	<u>367,085.00</u>
Net operating income (loss) using the Depreciation Dollar Method of writing off the Acquisition Adjust- ment	1,667,328.35	1,355,681.47	1,637,750.69	1,287,105.27	(216,143.69)
Deduct actual debt service	<u>(734,945.84)</u>	<u>(1,024,814.62)</u>	<u>(1,277,085.96)</u>	<u>(1,393,560.74)</u>	<u>(1,295,943.17)</u>
Net income (loss) using the Depreciation Dollar Method of writing off the Acquisition Adjust- ment	<u>\$ 932,382.51</u>	<u>\$ 330,866.85</u>	<u>\$ 360,664.73</u>	<u>\$ (106,455.47)</u>	<u>\$ (1,512,086.86)</u>

D. C. TRANSIT SYSTEM, INC.  
Comparison of Returns Allowed with Returns Realized  
During Rate Periods while under Jurisdiction of  
Public Utilities Commission

APPENDIX C  
WMATC Exhibit #1  
Schedule #2

	% Return Allowed on Rate Base	Average Rate Base per WMATC Study	Col 1X2= Annual Return	Total Return Allowed	Total Return Realized per WMATC Exhibit 1	Amount by Which Realized Return was under (over) Allowed Return
Period 8/15/56 - 8/30/58 PUC Order #4052	6.32%	\$18,591,917.43	\$1,175,009.18 X <u>2.044 yrs.</u>	=\$2,401,718.76	\$1,455,104.72	\$946,614.04
Period 8/31/58 - 3/5/60 PUC Order #4480	6.17%	\$14,775,168.50	\$ 911,627.90 X <u>1.515 yrs.</u>	=\$1,381,116.27	\$1,200,611.53	\$180,504.74
Period 3/6/60 - 1/17/61 PUC Order #4631	7.14%	\$16,613,835.73	\$1,186,227.87 X <u>.874 yrs.</u>	=\$1,036,763.16	\$1,167,186.79*	(\$130,423.63)
Period 1/18/61 - 4/13/63 PUC Order #4735	8.31%	\$18,952,068.00	\$1,574,916.85 X <u>2.236 yrs.</u>	=\$3,521,514.07	\$2,936,679.76*	\$584,834.31

\*These returns do not reflect the adjustments made in accordance with the establishment of the Court-Ordered Reserve pursuant to the order of the U. S. Court of the District of Columbia of 9/10/63.

APPENDIX D  
WMATC Exhibit #1  
Schedule #3

D. C. TRANSIT SYSTEM, INC.  
Comparison of Two Approaches for Determining Proper Returns  
with Actual Returns Realized During Rate Periods while under  
Jurisdiction of WMATC

	Allowable Return for Periods Shown	Return Realized per WMATC Exhibit 1			Amount by Which Realized Return is under (over) allowable return	
		Net Operating Income	Less Interest	Income to Stockholders		
<u>Based on allowable percentage of stockholders equity</u>						
4/14/63 - 1/26/66	12% allowed (X)	\$1,394,868.27	(1) \$4,531,179.64	\$2,295,017.94	\$2,236,161.70	\$ (841,293.43)
1/27/66 - 3/14/67	13% allowed (X)	482,610.25	(2) 762,788.25	1,481,134.45	(718,346.20)	1,200,956.45
3/15/67 - 1/27/68	14.08% allowed (Y)	307,538.00	1,357,620.38	1,157,722.69	199,897.69	107,640.31
1/28/68 - 10/30/68	26.4% allowed (Y)	526,382.00	185,413.41	964,007.72	(778,594.31)	1,304,976.31
10/31/68 - 12/23/68	No return allowed to equity holders (Y)	-	(109,587.56)	206,497.92	(316,085.48)	-
<u>Based on an annual dollar amount</u>						
4/14/63 - 1/26/66	\$504,838 per annum (X)	\$1,408,217.09	(1) \$4,531,179.64	\$2,295,017.94	\$2,236,161.70	\$ (827,944.61)
1/27/66 - 3/14/67	\$593,055 per annum (X)	669,420.99	(2) 762,788.25	1,481,134.45	(718,346.20)	1,387,767.19
3/15/67 - 1/27/68	\$592,324 per annum (Y)	516,033.00	1,357,620.38	1,157,722.69	199,897.69	316,135.31
1/28/68 - 10/30/68	\$791,471 per annum (Y)	599,009.00	185,413.41	964,007.72	(778,594.31)	1,377,603.31
10/31/68 - 12/23/68	No return allowed to equity holders (Y)	-	(109,587.56)	206,497.92	(316,085.48)	-
(1) Includes credits withdrawn from the original Court-Ordered Reserve which resulted from appeals of PUC rate case decisions of 3/2/60 (Order 4631) and 1/18/61 (Order 4735) in the amount of \$ 77,107.55						
(2) Includes credits withdrawn from the original Court-Ordered Reserve which resulted from appeals of PUC rate case decisions of 3/2/60 (Order 4631) and 1/18/61 (Order 4735) in the amount of 1,030,969.66						
\$1,108,077.21						

## APPENDIX E

D. C. TRANSIT SYSTEM, INC.  
 OPERATING STATEMENTS FOR THE TWO RATE PERIODS UNDER THE FARES AUTHORIZED  
 BY WMATC ORDERS NOS. 245 AND 564

	WMATC ORDER NO. 245 4/14/63 THRU 1/26/66	WMATC ORDER NO. 564 1/27/66 THRU 3/14/67	CUMULATIVE TOTALS 4/14/63 THRU 3/14/67
<u>Operating Revenue</u>			
Passenger Revenue	\$ 82,557,728.64	\$ 34,751,844.11	\$ 117,309,572.75
Other Operating Revenue	5,701,638.80	2,755,969.79	8,457,608.59
Total Operating Revenue	<u>\$ 88,259,367.44</u>	<u>\$ 37,507,813.90</u>	<u>\$ 125,767,181.34</u>
<u>Operating Revenue Deductions</u>			
Operating Expenses	\$ 76,528,935.32	\$ 33,666,413.97	\$ 110,195,349.29
Income Taxes	175,140.52	25,166.81	200,307.33
Other Taxes	1,964,647.58	1,191,851.82	3,156,499.40
Depreciation	6,452,789.28	3,182,589.14	9,635,378.42
Amortization of Acquisition Adjustment Per Books	(1,137,122.22)	(220,660.87)	(1,357,783.09)
Non-booked WMATC Operating Expense Adjustments	(275,825.85)	(69,365.56)	(345,191.41)
Court-Ordered Reserve	(95,107.24)	(1,265,657.97)	(1,360,765.21)
Total Operating Revenue Deductions	<u>\$ 83,613,457.39</u>	<u>\$ 36,510,337.34</u>	<u>\$ 120,123,794.73</u>
Net Operating Income or (Loss) Before Special Adjustments	\$ 4,645,910.05	\$ 997,476.56	\$ 5,643,386.61
Redistribution of entries relating to income tax savings on track removal: Reverse out entry made in 1965 which charged tax expense and credited deferred taxes for 1963 and 1964 tax savings	60,486.98		60,486.98
Redistribute direct charge to surplus made in 1966 for tax savings on track removal for 1963, 1964, 1965	(157,217.70)		(157,217.70)
Reduction of Court-ordered Reserve to comply with Court of Appeals instruction to give same treat- ment to depreciation deficiency on properties put below-the-line as those remaining above-the-line (Deficiency of \$252,688)	(17,999.69)	(234,688.31)	(252,688.00)
<u>Net Operating Income after above adjustments</u>	<u>\$ 4,531,179.64</u>	<u>\$ 762,788.25</u>	<u>\$ 5,293,967.89</u>

APPENDIX F

CALCULATION OF ALLOWABLE RETURN  
BASED ON PROTESTANTS FIXED DOLLAR THEORY

	PERIOD 4/14/63 - 1/26/66 WMATC RATE ORDER NO. 245	PERIOD 1/27/66 - 3/14/67 WMATC RATE ORDER No. 564
Annual return allowed	\$ 1,107,000	\$ 1,550,000
No. of years in effect	x 2.789	x 1.129
Total return allowed	<u>\$ 3,087,423</u>	<u>\$ 1,749,950</u>



APPENDIX G

CALCULATION OF ALLOWABLE RETURN  
 BASED ON ACTUAL INTEREST ALLOWED AND FIXED DOLLAR RETURN  
 ON EQUITY THEORY

	PERIOD 4/14/63 - 1/26/66 WMATC RATE ORDER <u>NO. 245</u>	PERIOD 1/27/66 - 3/14/67 WMATC RATE ORDER <u>NO. 564</u>
Annual return to equity holder allowed	\$ 504,911	\$ 593,055
No. of years in effect	<u>x 2.789</u>	<u>x 1.129</u>
Return to equity holder allowed	1,408,197	669,559
Debt service	<u>2,295,018</u>	<u>1,481,134</u>
Total return allowed	<u>\$3,703,215</u>	<u>\$2,150,693</u>

## APPENDIX H

CALCULATION OF ALLOWABLE RETURN  
 BASED ON ACTUAL INTEREST ALLOWED AND PERCENTAGE  
 RETURN ON BOOK EQUITY THEORY

	PERIOD 4/14/63 - 1/26/66 WMATC RATE ORDER NO. 245	PERIOD 1/27/66 - 3/14/67 WMATC RATE ORDER No. 564
Average stockholders equity		
Year ended 4/13/64	\$3,993,862	
1/26/67		\$3,345,982
x Rate of return allowed	$\frac{x .12}{\$ 479,264}$	$\frac{x .13}{\$ 434,978}$
Return to equity holder		
allowed year ended 4/13/64	\$ 479,264	
1/26/67		\$ 434,978
Average stockholders equity		
Year ended 4/13/65	\$4,425,462	
Period 1/27/67-3/14/67		\$2,915,373
x Rate of return allowed	$\frac{x .12}{\$ 531,055}$	$\frac{x .13}{\$ 378,999}$
Adjustment for less than		
1 year		$\frac{x .129}{\$ 48,891}$
Return to equity holder		
allowed year ended 4/13/65	\$ 531,055	
Period 1/27/67-3/14/67		\$ 48,891
Average stockholders equity		
Period 4/14/65-1/26/66	\$4,061,363	
x Rate of return allowed	$\frac{x .12}{\$ 487,364}$	
Adjustment for less than		
1 year	$\frac{x .789}{\$ 384,530}$	
Return to equity holder		
allowed - Period		
4/14/65 - 1/26/66	\$ 384,530	
Total return to equity holder		
allowed	\$1,394,849	\$ 483,869
Debt service	<u>2,295,018</u>	<u>1,481,134</u>
Total return allowed	<u>\$3,689,867</u>	<u>\$1,965,003</u>

# APPENDIX I

## CALCULATION OF ALLOWABLE RETURN BASED ON ACTUAL INTEREST ALLOWED AND PERCENTAGE RETURN ON PORTION OF EQUITY THEORY

	PERIOD 4/14/63 - 1/26/66 WMATC RATE ORDER <u>NO. 245</u>	PERIOD 1/27/66 - 3/14/67 WMATC RATE ORDER <u>NO. 564</u>
Average shareholders' equity in mass transportation activities	\$ 2,368,641(I-a)	\$ 413,054(I-b)
x Rate of return allowed	<u>x .12</u>	<u>x .13</u>
Annual return to equity holder allowed	\$ 284,237	\$ 53,697
x No. of years in effect	<u>x 2.789</u>	<u>x 1.129</u>
Total return to equity holder allowed	\$ 792,737	\$ 60,624
<del>Add Debt Service</del>	<del><u>2,295,018</u></del>	<del><u>1,481,134</u></del>
Total return allowed	<u>\$ 3,087,776</u>	<u>\$ 1,541,758</u>

## APPENDIX I-a

CALCULATION OF AVERAGE SHAREHOLDERS' EQUITY IN  
MASS TRANSPORTATION ACTIVITIES FOR PERIOD  
APRIL 1963 - JANUARY 1966

Month Ending	(1) Book Equity	(2) Investment in Subsidiary Companies	(3) Paraco Note Payable	(4)	(5)
				Real Estate & Other Rental Property	Shareholders Equity in Mass Transportation Activities (1)-(2)+(3)-(4)
1963 March	\$3,640,360	\$	\$	\$ 623,932	\$3,016,428
April	3,726,758			621,646	3,105,112
May	3,845,082			619,360	3,225,722
June	3,795,839			804,956	2,990,883
July	3,897,297			801,573	3,095,724
August	4,027,050			798,189	3,228,861
September	3,543,556			827,007	2,716,549
October	3,852,872			823,305	3,029,567
November	3,837,012			955,327	2,881,685
December	4,184,080	136,152		949,721	3,098,207
1964 January	4,161,710	136,152		945,860	3,079,698
February	4,173,736	136,170		950,809	3,086,757
March	4,215,528	136,170		949,211	3,130,147
April	4,392,805	1,536,170	1,000,000	945,655	2,910,980
May	4,528,975	2,304,956	1,000,000	214,102	3,009,917
June	4,462,046	2,304,956	1,000,000	213,208	2,943,882
July	4,579,166	2,304,956	979,167	918,601	2,334,776
August	4,013,099	2,308,826	979,167	914,984	1,768,456
September	3,961,848	2,308,826	979,167	938,566	1,693,623
October	4,108,506	2,308,826	958,333	963,872	1,794,141
November	4,123,605	2,308,826	958,333	1,010,859	1,762,253
December	4,837,952	2,499,514	958,333	1,008,318	2,288,453
1965 January	4,710,450	2,499,514	937,500	1,015,540	2,132,896
February	4,602,065	2,499,514	937,500	1,011,181	2,028,870
March	4,507,240	2,499,514	937,500	1,015,224	1,930,002
April	4,586,273	2,499,514	916,667	1,048,288	1,955,138
May	4,621,146	2,499,514	916,667	1,051,071	1,987,228
June	4,562,825	2,499,514	916,667	1,052,036	1,927,942
July	4,608,916	2,506,514	895,833	1,049,040	1,949,195
August	4,658,138	2,506,514	895,833	1,046,043	2,001,414
September	4,474,783	2,506,514	895,833	1,042,692	1,821,410
October	4,536,630	2,506,514	875,000	1,046,599	1,858,517
November	3,968,446	2,506,514	875,000	1,035,235	1,301,697
December	3,667,422	2,520,503	875,000	1,059,194	962,725
1966 January	3,575,970	2,520,503	854,167	1,056,043	853,591

Average Shareholders Equity for Period

\$2,368,641

## APPENDIX I-b

CALCULATION OF AVERAGE  
 SHAREHOLDERS' EQUITY IN MASS TRANSPORTATION ACTIVITIES  
 FOR PERIOD FEBRUARY 1966 - MARCH 1967

<u>Month Ending</u>	<u>(1) Book Equity</u>	<u>(2) Investment in Subsidiary Companies</u>	<u>(3) Faraco Note Payable</u>	<u>(4)</u>	<u>(5)</u>
				<u>Real Estate &amp; Other Rental Property</u>	<u>Shareholders Equity in Mass Transportation Activities (1)-(2)+(3)-(4)</u>
1966 February	\$3,553,926	\$2,520,503	\$854,167	\$1,059,883	\$ 827,707
March	3,602,639	2,520,503	854,167	1,061,052	875,251
April	3,725,115	2,520,503	833,333	1,061,930	976,015
May	3,806,838	2,520,503	833,333	1,066,237	1,053,431
June	3,709,052	2,576,503	833,333	1,071,003	894,879
July	3,778,397	2,576,503	812,500	1,094,069	920,325
August	3,885,406	2,576,503	812,500	1,391,128	730,275
September	3,735,494	2,576,503	812,500	1,431,190	540,301
October	3,820,386	2,576,503	791,667	1,453,763	581,787
November	3,882,371	2,576,503	791,667	1,492,632	604,903
December	3,390,848	2,576,503	791,667	1,511,106	94,906
1967 January	3,115,995	2,576,503	770,833	1,506,428	(196,103)
February	2,780,143	2,576,503	770,833	1,553,399	(578,926)
March	2,649,361	2,576,503	770,833	1,559,586	(715,895)
Average Shareholders Equity for Period					\$ 413,054